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SUBJECT: STIRRED, NOT SHAKEN: KAZAKHSTAN MANAGES THE LIQUIDITY  
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ASTANA 00000016 001.2 OF 003

11. (SBU) Summary. Top officials at the National Bank of Kazakhstan and the Financial Supervision Agency, as well as Kazakhstan's leading bankers see a very low risk of a default by a major Kazakhstani bank. The difficulties for the banking sector and the economy at large resulting from the global financial crisis are being alleviated by the government's \$4 billion assistance package, which may eventually be increased further. Policymakers and observers foresee only a moderate slowdown for the economy in 2008. On the other hand, policymakers appear somewhat frustrated in the face of the recent inflation surge. Still, they remain optimistic about the long-term prospects for the Kazakhstani economy, as long as there is no collapse of commodity prices. End summary.

Too Big to Fail: Major Banks Remain Confident  
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12. (SBU) Kazakhstan's banking sector continues to grapple with the sudden dry-up of global credit on which it had been heavily relying prior to July-August 2007 (ref A, B). The well has not run entirely dry: Jurgen Rigterink, Chairman of the Board of ABN Amro, told visiting Treasury Advisor Thomas Lanier on November 28 that lines of credit are still available to "some" Kazakhstani banks, albeit at higher interest rates. However, Rigterink noted, western industry analysts tend to lump Kazakhstani banks together, and the recent decision of the Development Bank of Kazakhstan (DBK) to pull its debt offering sent a bad signal to the market. (Note: A DBK official confirmed to Econoff that the Bank decided to cancel its Eurobond offering due to unfavorable market conditions. End note.) Still, Rigterink considers it "unlikely" that the Kazakhstani Government (GOK) would allow a top-five bank to fail. "There may be a forced sale, a takeover," Rigterink mused, "I wouldn't want to be an equity holder, but I would have no problem having a deposit [in one of these banks]." Similarly, Dauren Karabayev, Deputy CEO of Halyk Bank, told Advisor Lanier on November 30 that the chances of a failure by a top-six bank are "very small."

13. (SBU) The operational assumption of the Kazakhstani banking sector is that the country's big banks are "too big to fail," and the other banks do not matter. Yelena Bakhmutova, Deputy Chairman of the Financial Supervision Agency (FSA) told Advisor Lanier on November 29 that in some circumstances - such as when a bank is struggling and does not present "systemic risks" - it should be permitted to go bankrupt. Bank deposits, she noted, are guaranteed up to KZT 700,000 (approx. \$5,800), and "the system has already worked twice in the past. (Note: Baimukhanova was apparently referring to the failures of two regional banks, including that of Valut Tranzit in 2006, ref C. End note.) If a top-three bank

failed, she continued, "that would be a problem." However, she stated, "these banks do present systemic risks," making it clear that the government is committed to ensuring that no top Kazakhstani bank fails.

14. (SBU) There appears to be a consensus among Kazakhstani bankers that the biggest risk to the country's banking sector is the quality of the credit portfolio. Several bankers who met with Advisor Lanier in late November and visiting Federal Reserve Bank of New York (FRBNY) officials Hunter Clark and David Wright on December 10-11 singled out Alliance Bank as probably the most vulnerable of large Kazakhstani banks. Dauren Kereibayev, Alliance CEO, described his bank to Advisor Lanier as the leader in consumer finance, specializing in "very liquid" loans with an average size of \$2,000 and average term of two years. Kereibayev stated that these loans pose much lower risk than mortgages, to which Alliance has "the lowest proportionate exposure" of all its competitors. However, Asylbek Aydarkulov, Director of ATF Bank's International Department, told visiting FRBNY officials that there is "lots of fraud" with Alliance's "express-loan" program. The consumer credit rating system, he explained, is still woefully underdeveloped. Furthermore, he added, consumer lending is a difficult business in a culture where it is common to borrow several hundred dollars from family or friends.

15. (SBU) While several bankers said that the first seven to nine months of 2008 may be challenging, they remain generally upbeat about prospects for growth. Bank Turan Alem's (BTA's) CEO Dauren Kereibayev told Advisor Lanier that "the most pessimistic scenario" for 2008 is 10 percent asset growth. Magzhan Auezov, Managing Director of KazKommertsBank, predicted 5-10 percent, at least during the first half of 2008. BTA's Managing Director Georgiy Iosifyan told the visiting FRBNY officials that there is still \$7 billion circulating in the Kazakhstani economy outside the banking sector ("under the mattresses"). There is thus potential, Iosifyan concluded, to attract more deposits as confidence in the banking sector grows.

ASTANA 00000016 002.2 OF 003

16. (SBU) Several bankers noted that there is growing interest, particularly from the Middle East, in Kazakhstan's banks. FSA's Bakhmutova noted to Advisor Lanier that the GOK has abolished a 50 percent limit on foreign ownership of Kazakhstani banks. She also remarked that there are currently 35 banks in Kazakhstan, "too many in my opinion." She elaborated that the optimal number would be 20, and that the FSA is considering measures to encourage consolidation.

However, due to the credit crunch, the bankers see as unlikely a near-term foreign acquisition of a major Kazakhstani bank akin to the June 2007 (pre-credit crunch) purchase of Kazakhstan's ATF Bank by Austria's Unicredit. On the other hand, BTA's Iosifyan stated that BTA is currently trying to sell to a foreign investor its subsidiary Temir Bank, a large retail bank, the value of which Iosifyan estimates at \$1.5-2.0 billion. A lower-ranking BTA executive recently told Econoff that BTA's efforts to sell Temir are driven by necessity. BTA, he said, has been laying off staff and needs an influx of funds to service its debts.

The \$4 Billion Package -- Government Proactive  
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17. (SBU) The bankers, in general, appear to be quite supportive of the proactive role taken by the government in helping Kazakhstan navigate through the current financial turmoil. The sudden global liquidity dry-up has presented a shock not only to the Kazakhstani banking system but to the country's economy as a whole (ref A, B). The GOK's widely announced \$4 billion assistance package is meant to address both. The money, \$1 billion in 2007 and \$3 billion in 2008, is to be disbursed via Kazyna's Development Bank of Kazakhstan (DBK) and injected into the banking system as deposits in the accounts of participating commercial banks. The banks can use the funds for issuing credit but only in accordance with specific directives. Of the \$1 billion disbursed in 2007, \$400 million is earmarked for residential housing (for completion of ongoing construction projects in Astana by financing either construction companies or mortgage holders), \$400 million for SMEs, and \$200 million for innovative

industrial projects. The breakdown for the 2008 package does not appear to have yet been decided.

¶8. (SBU) BTA's Iosifyan told the FRBNY officials that the government has hinted of its willingness to increase the 2008 assistance package by another \$3 billion, bringing its total value to \$7 billion. National Bank of Kazakhstan (NBK) Chairman Anvar Saidenov explicitly stated to the FRBNY officials that the government would not tap into the National Oil Fund for the money, but rather that the funds will come from the national budget, through shifting resources from "other budgetary activities."

¶9. (SBU) The package is an outcome of close collaboration between the government and the leading banks. As one of the bankers mused, "a key difference between Kazakhstan and Russia is that here the government can get together with the top banks." The government's assistance to the banks comes with strings. According to Alliance's Kereibayev, the participating bankers promised not to finance new construction but to complete ongoing projects, and to borrow abroad only to refinance existing debt. Participating banks are also limited in their ability to engage in lending activities abroad.

#### Economic Outlook Still Robust

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¶10. (SBU) Some economic worries clearly remain. While FSA's Baimukhanova emphasized to Advisor Lanier that Kazakhstani banks are fully capable of paying out \$12 billion next year to service their external debts, she noted that this obligation "can affect the economy." Still, most bankers, as well as FSA's Baimukhanova and NBK's Sartbayev, foresee only a moderate economic slowdown, expecting the 2008 growth rate to be in the range of 5-8 percent. Baimukhanova, however, stated that the economic risks may increase in 3-5 years, because the banks' borrowings - which started only in 2002 - will then result in a high redemption burden. Baimukhanova opined that if that period coincides with a fall in commodity prices, the Kazakhstani economy will face problems.

¶11. (SBU) Short-term challenges also remain. In November, year-on-year inflation hit 17.5 percent, propelled by soaring food prices (up nearly 25 percent year-on-year). This remains a politically sensitive issue. According to one private sector analyst, on average nearly 40 percent of household expenditures are spent on food. Speaking to Advisor Lanier, NBK's Deputy Chairman Sartbayev implied that the NBK faces limited options in controlling inflation. In Kazakhstan, Sartbayev explained, lack of liquidity actually contributes to inflation via higher costs for importers financing their goods purchases. Thus, raising rates may actually fuel inflationary pressures. What does help against inflation, he

ASTANA 00000016 003.2 OF 003

continued, is a steady exchange rate. On this score, NBK Chairman Saidenov told the FRBNY officials that the NBK has no particular target for the exchange rate. (Comment: This remark is somewhat contradicted by the tenge's remarkable failure to venture outside the 120-121 per dollar range over several months. End comment.) Saidenov stated that the central bank's policy is "to allow fluctuations both ways but to moderate them." Due to balance of payment pressures (ref B), Saidenov expects some pressure on the tenge in 2008. On this, he stated, "We are willing to strike a balance between spending a couple of billion dollars from reserves to support the tenge on one hand, and allowing moderate depreciation on the other."

Comment

¶12. (SBU) Nearing the six-month mark following the advent of the liquidity crunch, the Kazakhstani economy and the banking sector appear to be taking the challenges in stride. Most of the impact, so far, has been on the office and residential construction sectors in Almaty. Economic growth forecasts have been cut to some extent, but the government's commitment to supporting the financial sector is clearly providing important reassurance. At the same time, the comments by National Bank Deputy Chairman Sartbayev on inflation demonstrate policymakers' frustration with the inflation surge,

which cannot be controlled with monetary contraction and is largely fueled by rising global commodity prices, especially on grain. The remarks by the Financial Supervision Agency Deputy Chairman Baimukhanova on possible economic risks in 3-5 years' time echo another aspect of Kazakhstan's economic reality: the country, with its strong record of prudent fiscal and monetary policies, is well-positioned to withstand substantial economic shocks-- as long as commodity prices remain high. On this front, Kazakhstan appears, for now, to have little reason to worry.

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